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Washington, DC 20036

MANAGEMENT LETTER

December 27, 2002

CONFIDENTIAL

Mr. Otto J. Wolff
Chief Financial Officer and Assistant Secretary for Administration
U.S. Department of Commerce
14th and Constitution Avenue, N.W.
Washington, D.C. 20230

Dear Mr. Wolff:

We have audited the consolidated financial statements of the Department of Commerce (Department) as of and for the years ended September 30, 2002 and 2001, and have issued our report thereon dated December 27, 2002. We did not audit the financial statements of the National Technical Information Services (NTIS) or the U.S. Patent and Trademark Office (PTO), which combined, represent 10 percent and 2 percent of the total consolidated assets and net costs of operations of the Department, respectively. In planning and performing our audits of the consolidated financial statements, we considered the Department's internal control over financial reporting, in order to determine our auditing procedures for the purpose of expressing an opinion on the consolidated financial statements. An audit does not include examining the effectiveness of internal control, and does not provide assurance on internal control over financial reporting.

During our FY 2002 audit of the Department's consolidated financial statements, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls, that in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the consolidated financial statements. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control that might be reportable conditions.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.



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In our *Independent Auditors' Report*, dated December 27, 2002, we have reported one material weakness related to the Department's financial management systems, and one reportable condition, relating to the Department's accounting for property.

Our audit procedures were designed primarily to enable us to form an opinion, based on our audit and the reports of other auditors, on the Department's consolidated financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that exist. However, we also take this opportunity to share our knowledge of the Department, gained during our work, to make comments and suggestions that we hope can be useful to you.

Although not considered to be reportable conditions (except for the property-related matters at the National Oceanic and Atmospheric Administration, which collectively comprise a reportable condition on accounting for property), we noted certain matters involving internal controls and other operational matters, which are presented in the Exhibits A through G, attached, for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the Department's internal controls or result in other operating efficiencies. Each exhibit presents the status of prior year management letter comments. We have not considered the Department's internal controls since the date of our report.

Other auditors reported comments and recommendations related to NTIS and PTO separately to management of those bureaus.

We appreciate the courteous and professional assistance that the Department's personnel extended to us to complete our audit timely. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Department's management and the Department's Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

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*These matters, collectively, support the overall reportable condition on accounting for property, reported at the Departmental level. They are presented herein, to aid NOAA in addressing these issues.

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Intra-governmental Balance Reconciliation Results Should be Improved

In fiscal year (FY) 2002, the Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements*, required federal agencies to reconcile their intra-governmental asset, liability, and revenue amounts with their trading partners at March 31, and September 30, 2002. Quarterly reconciliations are required beginning December 31, 2002.

The Department was not able to substantially reconcile its intra-governmental asset, liability and revenue amounts with its trading partners at September 30, 2002. Some of the Department's trading partners have had difficulty providing information necessary to reconcile these balances and transactions because of differing methods used to provide details. Because most Federal agencies have similar problems with intra-governmental reconciliations, the U.S. Department of Treasury has established an Intra-governmental Eliminations Task Force, to develop standard policies and procedures for Federal agencies to follow.

The Department's inability to reconcile its intra-governmental transactions impairs Treasury's ability to reliably and accurately eliminate intra-governmental transactions in preparing the Consolidated Financial Statements of the U.S. Government.

Recommendations:

We recommend that the Office of Financial Management (OFM):

1. Continue to work closely with the Intra-governmental Eliminations Task Force, to develop policies and procedures that will assist the Department in reconciling intra-governmental transactions with its trading partners.

Certain Operational and Accounting Handbooks Should be Updated

As the Department continues with (1) the Department-wide full implementation of the Department's financial system; Commerce Administrative Management System (CAMS) and the Sunflower property system; (2) use of the Department of Treasury's grant-related system, Automated Standard Application for Payments (ASAP); (3) submission of comparative quarterly financial statements to OMB in FY 2003; and (4) preparing for OMB's accelerated due date for the FY 2004 Performance and Accountability Report, the Department's OFM should review the Department's existing operational and accounting handbooks, to ensure that the daily activities of its employees are in line with the current, and increasing, reporting requirements.

Although some of our comments are based on the bureau-level handbooks, manuals, or directives that we observed during our detailed test work, most manuals need to be addressed at the Department-wide level, to ensure that the information that is required at the Department level

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is provided in a consistent format and within the timeframes outlined in the Department's *Financial Statement Guidance*, that is updated annually.

Specifically, some of the handbooks, manuals, or directives that we found could be improved are as follows:

- During our review of budget procedures, we noted that there are manual procedures in place that are not taking advantage of CAMS functional capabilities. The budget handbooks or manuals were developed prior to the implementation of the CAMS budget module; therefore, the handbooks or manuals should be reviewed and updated at the Department level to be consistent with CAMS budget module user manuals.
- During our review of property, and as noted in the FY 2001 management letter, we noted that the Department's *Personal Property Management Manual* requires that "Property accountability records be reconciled periodically with the financial control accounts in accordance with procedures established by servicing financial accounting activities." However, the term "periodically" is not defined in terms of time periods, such as monthly or quarterly. Thus, the individual bureaus interpret the interval to complete property reconciliations differently. Additionally, we noted that the reconciliation procedures are not specific enough to provide for consistent control.
- During our review of grants at several bureaus, we noted that grant files were "periodically" or "annually" reviewed, resulting in missing documentation at a specific point in time without adequate follow-up or timely close out of grant files (see separate bureau-level exhibits). Similar to the property manual, the term "periodically" or "annually" is interpreted differently across the Department.
- During our review of the *Federal Managers' Financial Integrity Act* (FMFIA), we noted that the Department-level directive is outdated, and the bureaus interpreted the self-assessment requirements differently. This matter is discussed further in the separate comment, below.

Recommendation:

We recommend that the Department's OFM:

2. Coordinate with all bureaus to review existing operational and accounting handbooks, manuals, and directives, to ensure that the daily activities of its employees are in line with the current, and increasing, reporting requirements and Department-wide implementation of CAMS.

Federal Managers' Financial Integrity Act (FMFIA) Oversight Should be Improved

FMFIA states that by December 31, 1983, and by December 31 of each succeeding year, the head of each executive agency [*Department*] shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement:

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- That the Department's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1); or
- That such systems do not fully comply with such requirements.

Although the Department and its bureaus conduct a self-assessment of "systems" related to internal accounting and administrative control, all of the bureaus do not have a consistent interpretation of the word "systems" as it applies to the FMFIA. Congressional intent for this act was not limited to information technology (IT) systems, but is intended for agencies to include in their self-assessments a review of the "methods" of internal accounting and administrative controls.

Based on our limited review, we found that:

- The National Oceanic and Atmospheric Administration (NOAA) has an office, Audit, Internal Control, and Information Management Office (AICIMO), that appears to address the Act, as intended. This office maintains a robust Internet site, which documents extensive internal control evaluations (both manual and IT).
- The Bureau of the Census (Census) has an Administrative Manual, Chapter F22, *Accounting/Financial Management Systems Reviews* dated January 29, 1991, which focuses on "systems" (that is, software applications and hardware that support financial and operational activities). In addition to the system reviews performed according to this manual, Census prepares corrective action plans for both IT and non-IT audit recommendations. Census management advised us that they did not believe that any other matters, beyond prior year audit findings, warranted inclusion in its FMFIA submission. We were not provided documentation of any internal assessments that Census may have performed over its non-IT accounting and administrative controls, in order to make the assertion that no other matters, beyond the prior year audit findings, should be reported under FMFIA.
- The National Institute of Standards and Technology (NIST) and others perform a self-assessment based on the U.S. General Accounting Office (GAO) guidance, *Checklist for Reviewing Systems Under the Federal Financial Management Improvement Act*. This checklist focuses on "IT systems" only. In addition to the checklist, these bureaus provide corrective action plans to the Department's OIG for review. However, these plans only address audit findings. Therefore, it appears that these reviews do not address the non-IT system controls.

The Department's directive dated October 22, 1988 defines internal control system as, "All formal measures taken and actions prescribed by management to establish operations which fully meet programmatic or administrative responsibilities. Each level of management participates in developing a system of control, which provides reasonable assurance that program and administrative activities are carried out effectively. Internal control measures or actions:

- Define what should be done (manuals, directives, desk procedures, etc.);
- Monitor operations as they occur (supervision, use of checklists, computer edits, etc.); and

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- Establish feedback sources on operation (quality assurance reports, client input, financial reports, etc.).

Based on our limited review, it does not appear that all bureaus have followed the Department's guidance, including defined roles and responsibilities and consistently including all internal control systems (both manual and IT) within the review.

Recommendations:

We recommend that the Department:

3. Take a more proactive role in coordinating the annual FMFIA self-assessments and ensuring that the intent of the Act is followed; and
4. Review and revise the Departmental directive to assist the bureaus with the timing, extent, and performance of the self-assessments.

Analyses of Net Position Should be Improved

During our review of the net position analyses, we noted that there were significant reconciling items that were not explained as of December 27, 2002. Although, significant reconciling items were eventually resolved, we are concerned that the analyses were not completed on a timely basis.

Recommendations:

We recommend that the Department:

5. Perform net position analyses by fund group quarterly, at a minimum, to ensure that the proper balances are reflected in Unexpended Appropriations and Cumulative Results of Operations.

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Status of Prior Year Management Letter Comments
Departmental Level**

Comment Number	Reported Comment	KPMG's Recommendation	Department Comments	KPMG Assessment of Current Status
01-05	Intra-governmental Confirmations Need to be Sent Timely	OFM should identify all agencies' contact information earlier in the process to ensure that all confirmations are sent by the due date.	Completed.	Completed.
01-09	Property Reconciliation Requirements Can be More Specific	The Department should consider revising its policy to define the interval at which property reconciliations should occur.	Ongoing.	Ongoing (see comments in Exhibit A).

Key to Report References:

01-XX KPMG's Management Letter, issued in conjunction with the Department's September 30, 2001 consolidated financial statements.

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Accounting for Construction Work-in-Progress (CWIP) Should be Improved

The National Oceanic and Atmospheric Administration (NOAA) has made improvements in its accounting for CWIP in FY 2002; however, we continued to identify exceptions in this area. Specifically, we noted the following:

- In May 1994, a Presidential directive was issued to construct a new satellite system referred to as the National Polar Operational Environmental Satellite System (NPOESS). The NPOESS was approved for development in FY 1995. However, NOAA delayed the recording of the initial development, engineering and architectural costs of this system, as CWIP, until the systems contract was awarded in FY 2002. Instead, approximately \$171.5 million, was expensed in prior years, when incurred. When this CWIP project was capitalized, NOAA improperly moved all expenses incurred under this program from FY 1995 to 2002 into CWIP, which understated FY 2002 expenses. (NOAA recorded a correcting adjustment to FY 2002 expenses and a prior period adjustment to correct the accounting for prior year costs.)
- NOAA did not make a FY 2002 Management Fund adjustment to its CWIP balance, to appropriately reflect overhead costs, because the amount was calculated and provided to the Financial Reporting Branch after the financial statement cut-off date. As a result, the September 30, 2002 CWIP balance is understated by approximately \$2.6 million.
- Approximately \$5 million of accrued costs remain in the GOES I-M satellite CWIP activity, although this satellite series was considered complete on December 12, 2001. Based on NOAA's CWIP policies and procedures, once a satellite series is completed, the remaining CWIP accrued costs should be included as capitalized costs of the final satellite. Therefore, the \$5 million should have been included in the total cost of the GOES-12 (M) satellite, as of September 30, 2002, in the personal property system. While the overall property balance is not misstated, NOAA did not record the effect of FY 2002 depreciation expense, amounting to approximately \$800 thousand, on this portion of the completed satellite.
- One project was properly classified as CWIP at September 30, 2002, although the activity manager originally did not intend to capitalize the remaining costs in this project and did not prepare a schedule of completion for the project, which is a required document according to NOAA's CWIP policy.
- Two CWIP projects tested were included in both the CWIP and real property balances at September 30, 2002. One project was completed in FY 2002; therefore, it should have been removed from the CWIP balance. The other project was considered incomplete at September 30, 2002; therefore, it should not have been included in the real property balance. (NOAA recorded the correcting adjustments amounting to approximately \$3 million and \$1 million, to the CWIP and real property balances, respectively, for the September 30, 2002 consolidated financial statements.)
- Four CWIP reconciliations tested did not have differences that were adequately and clearly identified and explained by the activity manager. The thorough reconciliation

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of activity manager records to the CWIP subsidiary ledger (e.g., the 15 C Report) is an important internal control over the accounting for CWIP.

- Two CWIP reconciliations tested had differences identified by the activity manager that were posted incorrectly by the Financial Reporting Branch. (NOAA recorded the correcting adjustments, totaling approximately \$100,000.)
- One task was not reported in the year-end CWIP reconciliation, because the activity manager did not include these costs in his detailed reconciliation; however, the CWIP costs remained in the subsidiary ledger. As of September 30, 2002, we determined that this project was only at a pre-conceptual design phase, and thus these design costs will not be part of the final construction project. Therefore, based on NOAA's CWIP policies and procedures, all accrued costs related to the abandoned design concept should have been removed from the CWIP balance, and should have been immediately expensed. (NOAA recorded an audit adjustment for approximately \$4 million, after confirmation by the task manager.)

These matters, in conjunction with the comments below, regarding personal property controls, personal property adjustments, and lease accounting, result in a reportable condition in internal controls that is reported at the overall Department of Commerce level. Our recommendations, below, provide more detail than the high-level recommendations included in the *Independent Auditors' Report*, dated December 27, 2002.

Recommendations:

We continue to recommend that the NOAA Finance Office and the appropriate CWIP activity managers:

1. Ensure that all adjustments necessary to the 15 C Report are properly identified on the detailed reconciliation and are explained in adequate detail; and
2. Verify the valuation of the CWIP balances in the 15 C Report by ensuring all adjustments at fiscal year-end, or on a monthly basis, are posted timely by the NOAA Finance Office and that completed items are not included in the final balance.

We also recommend that the CWIP activity managers:

3. Reconcile on a timely basis all CWIP projects that they are responsible for by verifying that the documentation in the CWIP files agrees to the most current 15 C Report by project and phase;
4. Capitalize costs for the development and construction of satellite systems, as CWIP, when incurred, including estimating costs incurred by vendors, if necessary. Research and development costs relating to proposed satellite systems should be expensed;
5. Update NOAA's current CWIP policy to address cost accumulation and capitalization procedures for all satellite systems under development;

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6. Immediately notify the Budget and Finance Offices, in the event a CWIP project is terminated, or a design is abandoned;
7. Ensure that all completed CWIP projects are properly removed from the CWIP records and added to the property accounts, and that the guidelines included within the CWIP policies and procedures are adhered to regarding transfers of completed projects; and
8. Develop a schedule of capitalization before any activity is categorized as CWIP.

We also recommend that NOAA's Budget Office:

9. Develop a process to calculate and record the Management Fund cost allocation adjustments to CWIP, on a schedule to meet the accelerated reporting requirements.

Controls Over Personal Property Should be Improved

During our test work over personal property, we noted that the personal property balances in the new property system, Sunflower, did not agree with the general ledger balance for equipment and accumulated depreciation for equipment, by approximately \$1 million and \$2 million, respectively. The Sunflower system balance was subjected to auditing procedures, and was determined to be fairly stated; therefore, the general ledger balance was incorrect at September 30, 2002. NOAA Finance Office and Personal Property Office personnel could not identify why the differences occurred.

We also identified 1 of 15 personal property additions tested where the acquisition date was entered incorrectly into the property system. The date entered was October 8, 2001, but should have been November 23, 2001, according to the *Supply, Equipment, or Service Order Form*. Incorrect acquisition dates affect the amount of depreciation expense that is recorded for that item.

Recommendations:

We recommend that the NOAA Personal Property Office and Finance Office:

10. Establish procedures to reconcile the property balances between Sunflower and the general ledger, on at least a quarterly basis, to ensure that balances are continually reviewed and any differences immediately investigated and resolved; and
11. Reconcile all information entered into the Sunflower system with supporting documentation.

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Personal Property Adjustment Monitoring Should be Strengthened

During our test work over personal property, we tested 54 transactions classified or should have been classified as prior period adjustments, and noted the following:

- 43 adjustments represented property items identified through an inventory performed at the Wallops Island facility. This inventory was performed because no supporting documentation was available for property items purchased at this facility, which were purchased before FY 1994. In accordance with NOAA's policies, property items purchased before FY 1994 that cannot be adequately supported must have a CD-509 completed by the property custodian. This form documents the basis for valuing the property item. We noted that these adjustments were not accompanied by completed CD-509 forms. As a result of our finding, the CD-509s were completed for all items by the completion of our audit.
- 3 adjustments were not adequately supported, and based on further investigation, the adjustments should not have been made. Although the Personal Property Office discovered these errors and recorded the appropriate adjustments within the Sunflower system, they failed to notify the Finance Office who generated the property roll-forward. (This matter had no financial statement impact, but increased the complexity of auditing this area, because the roll-forward was incorrect.)
- 2 out of 36 additions tested should have been classified on the personal property roll forward as prior period adjustments, but were not. The supporting NOAA Forms 37-6 for these items indicated that they were purchased on September 21, 2001. Therefore, these items represent prior period adjustments. Although the ending balance of personal property was properly stated, the current year activity was misstated.

We also noted that some of our September 30, 2001 audit adjustments were recorded in the general ledger as FY 2002 prior period adjustments, although the beginning balances of the property accounts were properly stated. NOAA made correcting entries for these items, as of September 30, 2002.

Recommendation:

We continue to recommend that the NOAA Personal Property Office and Finance Office:

12. Perform manual review procedures to ensure that all prior period adjustments represent valid adjustments to the prior year balances, and that the property roll-forwards are subjected to supervisory review. Immaterial prior period adjustments should be recorded as current year activity. Materiality should be addressed by NOAA management, but could be assessed at \$1,000,000, for example, which represents an amount less than .1% of its net personal property balance.

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Personal Property Lease Accounting Should be Strengthened

During our test work over personal property leases for FY 2002, we noted that the NOAA Procurement Office revised all of its Lease Determination Worksheets (worksheets) for open leases. These revisions were due to upgrades and additions identified, as well as executory costs that were subsequently identified, based on a detailed review of the supporting contracts.

We reviewed the worksheets for the seven capital leases audited previously, and one new capital lease, as well as the five operating leases audited previously, and one new operating lease, and noted the following:

- For 6 of the 14 leases tested, personnel that were unfamiliar with lease accounting completed the worksheets, before revision. A representative from the Procurement Office did not work with the preparer of the worksheets, to ensure that they were completed properly and timely.
- For 6 of the 14 leases tested, the worksheet was documented as being reviewed, before revision. However, the reviewer did not agree the worksheet data to the supporting contracts and modifications, and did not verify the other information. Therefore, the review was not effectively performed, and did not detect the errors that were made.
- For 1 of the 14 capital leases tested, after revision, we noted that the present value of minimum lease payments was computed incorrectly. The present value at September 30, 2002, should have been \$613,923 versus \$514,947. NOAA agreed with our value and subsequently corrected the worksheet. There was no financial statement impact for this difference.
- Because of the lateness of the revisions to the capital lease worksheets during the year, NOAA did not record current year activity (e.g., correction of lease asset balances, FY 2002 depreciation expense on capital leases, or amortization of the capital lease liability) to its asset and liability accounts for personal property capital lease accounts. As a result, the capital lease asset balances were overstated by approximately \$1.7 million, and the capital lease liability was overstated by approximately \$4 million, at September 30, 2002. (NOAA did not record the asset-related adjustment due to offsetting asset adjustments; but the liability adjustment was recorded at September 30, 2002.)

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Recommendations:

We recommend that the NOAA Personal Property Office and the Procurement Office:

13. Perform a thorough review of all new capital and operating leases during the year, to ensure that the leases are properly classified and recorded in the financial statements. The supporting Lease Determination Worksheets should also be reviewed in detail, and should be compared to supporting documentation;
14. Review the policies and procedures on accounting for capital leases, and ensure that they are adequately communicated to its personnel. This should also include the procedures for computing the present value of minimum lease payments, and the need to maintain documentation supporting all disclosures in the Lease Determination Worksheets; and
15. Ensure that all Lease Determination Worksheets are completed and reviewed by personnel knowledgeable of lease accounting, and that copies of contracts and other supporting documentation is obtained by the reviewer, for use in the review.

We also recommend that the NOAA Personal Property Office and the Finance Office:

16. Work with the Procurement Office to improve the controls over accounting for personal property capital leases. These controls should include periodic reviews to ensure the controls are operating and that all new leases are properly accounted for.

Cost Allocation Over and Under Applications Should be Reviewed

During our test work over cost allocations, we noted there were approximately \$36 million of overhead costs that were over-applied, based on the rates used to automatically charge programs for overhead throughout the year. While we understand that a portion of the amount over-applied was planned due to system limitations, the unplanned amount of approximately \$15.8 million was significant to FY 2002. Although a manual adjustment process was used to correct the over-applied overhead amount, the adjustment was not finalized until after the end of the fiscal year. Since these adjustments impact the internal and external reporting related to costs by task number and account control number for financial statement preparation and management review, it is important that the amount over-applied or under-applied be reduced to an insignificant amount to potentially reduce the time needed to close-out the year and to properly reflect program activities throughout the year. The timely adjustment of any over or under application will become even more important in the future as a result of the accelerated financial reporting deadlines.

NOAA has addressed the shortcomings of its indirect cost process in its *Guidance on the Use of Indirect Costs for FY2000* directive, issued in September 2000, and its *Updated Budget Policy and Procedures on the Interim Indirect Costs Process* directive, dated

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November 21, 2001. NOAA anticipates that implementation of the CAMS will assist in improving its cost allocation process.

A FY 2000 National Academy of Public Administration report entitled, *Improving the NOAA Budget and Financial Management Processes*, also recommended that NOAA establish a working capital fund to place corporate cost activities on a fee-for-service basis. NOAA indicated that it may consider this, once CAMS is implemented.

Recommendations:

We continue to recommend that the NOAA Budget Execution and Operations Division:

17. Enforce the *Updated Budget Policy and Procedures on the Interim Indirect Costs Process* directives, to ensure that all overhead application rates are reflective of actual operations, and document the rationale for rates that are based on judgmental assessments; and
18. Consider establishing a separate working capital fund after implementation of CAMS, to assist with (1) the tracking of overhead and other indirect costs with their related obligations, and (2) the resulting internal cost allocations.

Environmental Liability Policies Should be Documented

During our test work over environmental liabilities, we noted that NOAA recorded a \$17 million contingency on the Pribiloff Island cost estimate in FY 2002. We noted that while the contingency amount appeared reasonable, NOAA does not have a policy on recording such contingencies, and does not have a documented methodology for its calculation.

Recommendation:

19. We recommend that the NOAA Environmental Compliance and Safety Division develop a policy to address the recording of contingencies used in developing its environmental liability cost estimates. This will ensure a consistent application of contingencies in all environmental projects.

Accounting for Grant Advances and Grant Payables Should be Improved

During our NOAA test work over grant advances and grant payables, we noted the following:

- Sixteen of twenty closed grants tested were not properly de-obligated as of September 30, 2002. The Accounting Operations Division does not have authority to de-obligate funds on grants until the receipt of the closeout checklist from the Grants Management Division; however, these remaining funds will not be paid out since the

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grant is closed, and thus all the remaining funds on closed grants are invalid undelivered orders. Of the 324 grants closed in FY 2002, we determined that there was a remaining undelivered orders balance of \$2,129,807. (NOAA recorded an adjustment to de-obligate this amount, for purposes of preparing the September 30, 2002 consolidated financial statements.)

- NOAA did not properly de-obligate \$1,435,023 of expired grants, although the various line offices requested these funds to be de-obligated.
- Two of ten active grants tested had a discrepancy between either the grant start or end dates in NOAA's Grant System (NGS) and the dates on the supporting documentation.
- The grant amount reported on the CD-451 of one grant did not agree with the information in NGS.
- One of ten active grants tested did not contain the required reports (SF 269, SF 272, Progress Report) in the supporting file, which caused the grant recipient to be noncompliant with the grant award conditions. This grantee has not filed any required reports since FY 2000.
- Three of twenty closed grants tested did not contain evidence of the Grant Management Division's attempt to obtain past due required reports from grantees.
- One of three grantee audit reports reviewed did not have a management decision issued within the required response time of six months.

Recommendations:

We recommend that the NOAA Accounting Operations Division and Grants Management Division:

20. Ensure that funds are timely de-obligated for closed and expired grants, as well as perform a year-end review to ensure that all funds have been properly de-obligated.

We also recommend that the Grants Management Division:

21. Establish an internal review process, so that a supervisor systematically reviews data entered into NGS;
22. Track all required reports submitted by grant recipients in a timely manner; and
23. Issue all management decisions within the required deadlines.

Interagency Agreement Policies and Procedures Should be Followed

NOAA enters into numerous interagency agreements with Federal and non-Federal agencies. NOAA records all interagency agreements in its financial management system, FIMA, and produces a report, the *Reimbursable Task Status Billing Report* (RTSBR), which discloses the status of the interagency agreements where NOAA is the performing agency, by task number. The RTSBR reflects the total accrued costs, billings and collections, and unbilled costs relating to each interagency agreement.

**Department of Commerce
FY 2002 Management Letter Comments for the
National Oceanic and Atmospheric Administration, Continued**

We performed detailed tests of individual reimbursement agreements to determine NOAA's compliance with billing agreement terms and to determine if controls were in place for accumulating task costs and billings for work performed. From this test work, we noted:

- One of thirty interagency agreement tasks tested was not properly classified. This agreement should have been assigned as a "B" Task number, rather than an "A" task number, which affects the billing terms;
- One of thirty interagency agreement tasks tested was not properly accrued at September 30, 2002; and
- One of thirty interagency agreement tasks tested exceeded the funding level by \$176,065. This was in violation of the reimbursable agreement. The overrun was corrected through a transfer to a direct task, before fiscal year end.

Recommendations:

We recommend that:

24. The Deputy CFO emphasize to NOAA the need to thoroughly review each reimbursable agreement to ensure all agreements are properly classified and accruals are proper; and
25. NOAA implement internal controls to prevent reimbursable task overruns.

Accounting for Supplementary Stewardship Reporting Should be Strengthened

During our test work over Supplementary Stewardship Reporting, we noted the following matters affecting disclosures for stewardship investments and heritage assets.

Stewardship Investments - NOAA does not report performance outcomes and measures for its stewardship investments (e.g., human capital, and research and development program), as required by Statements of Federal Financial Accounting Standards (SFFAS) Number 8, *Supplementary Stewardship Reporting*. In addition, we noted that NOAA reports its stewardship investments based on obligation data, rather than expenses.

SFFAS No. 8 indicates, "By no later than the third year after the effective date of this standard, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported. If outcome data are not available, output data that best provide indication of the intended program outcomes shall be used to justify continued treatment of expenses as investments until outcome data are available." SFFAS No. 8 also indicates that investment data should be based on the same basis of accounting as the financial statements.

**Department of Commerce
FY 2002 Management Letter Comments for the
National Oceanic and Atmospheric Administration, Continued**

NOAA believed that outcome or output data was not required to be presented to meet the minimum disclosure requirements described in OMB Bulletin 97-01; however, since SFFAS No. 8 became effective for FY 1998, the outcome/output disclosures were required no later than FY 2001. Even the minimum reporting requirements specify that historical costs, rather than outlays (e.g., obligations) be determined, and specify that beginning in FY 2002, such costs for that year and the preceding four years be reported. Statements of Federal Financial Accounting Standards take precedence over OMB Bulletins in the Federal hierarchy of generally accepted accounting standards, per the American Institute of Certified Public Accountants.

Heritage Assets – We noted differences between NOAA’s reported balance of heritage assets and the Personal Property Office’s inventory listing of heritage assets. We were told that the Personal Property Office completed the reported heritage asset disclosures using information gathered directly from the heritage asset stewards. However, the updated information has not been entered into the heritage asset inventory listing.

We also noted the NOAA understated the number of reported acres, by 53,406 acres, for the National Estuarine Research Reserves, in the stewardship report submitted to the Department. This understatement was corrected in the final consolidated financial statements.

Recommendations:

We recommend that:

26. NOAA’s Budget Office initiate procedures to report performance outcomes and measures for its stewardship investments. This includes identifying the performance outcomes and measures, and requiring the respective departments to gather the information necessary to report this information for the FY 2003 financial statements;
27. NOAA’s Personal Property Office ensure that the heritage asset inventory listing database is completed and kept up-to-date, to ensure accuracy; and
28. NOAA’s Financial Reporting Branch ensures the accuracy of the compilation of stewardship reporting information.

**Department of Commerce
Status of Prior Year Management Letter Comments
National Oceanic and Atmospheric Administration**

Comment Number	Reported Comment	KPMG's Recommendation	NOAA Comments	KPMG Assessment of Current Status
96-03, 00-06, 01-05	Inter-agency agreements are not supported or are improperly classified.	Procedures should be implemented to determine proper assignment of task codes and reimbursable task plans are adequately supported, and that billings are performed in accordance with the inter-agency agreement.	Ongoing.	Ongoing (see comments in Exhibit A).
98-03, 99-04, 00-04, 01-04	Civil Monetary Penalty internal controls should be strengthened.	Ensure that all appropriate policies and procedures are adhered to, including sending dunning notices and computing interest rates.	Completed.	Completed.
98-07, 99-03, 00-03, 01-03	Fund Balance with Treasury reconciliation procedures should be improved.	The unreconciled difference between the TFS-2108 and general ledger must be researched as well as the deposits-in-transit account.	Completed.	Completed.
98-09	CAMS implementation should be improved.	Finalize the Security Plan for the CAMS application.	Ongoing.	Ongoing (see separate letter reporting EDP comments).
99-01, 00-01, 01-01	Cost allocation over and under applications should be reviewed.	Analyze the current process for applying overhead costs to task codes to ensure over/under	Ongoing.	Ongoing (see comments in Exhibit A).

**Department of Commerce
Status of Prior Year Management Letter Comments, Continued
National Oceanic and Atmospheric Administration**

Comment Number	Reported Comment	KPMG's Recommendation	NOAA Comments	KPMG Assessment of Current Status
		applied amounts are minimal.		
00-02, 01-07	Accounting for Personal Property Adjustments Should be Strengthened	Identify any transactions reported in the deletions category due to a change in bar code number or other non-financial data.	Ongoing.	Ongoing (see comments on personal property prior period adjustments in Exhibit A).
00-05, 01-09	Controls Over Accounting for Personal Property Leases Should be Improved	Review policies and procedures over capital lease accounting and maintain documentation to support disclosures in the lease determination worksheet.	Ongoing.	Ongoing (see comments in Exhibit A).
01-02	Accounting for Grant Advances and Grant Payables Should be Improved	Perform reviews of grant information entered into the system and ensure that current policies and procedures are proper and are adhered to.	Ongoing.	Ongoing (see comments in Exhibit A).
01-06	Accounting for Undelivered Orders Should be Improved	Establish a procedure to record obligations with adequate supporting documentation and to aggressively follow up to ensure contracts are properly and timely de-obligated.	Completed.	Completed.
01-08	Controls Over Personal Property Should be Improved	Obtain the required supporting documentation for all property placed in service during the fiscal	Ongoing.	Ongoing (see comments in Exhibit A).

**Department of Commerce
Status of Prior Year Management Letter Comments, Continued
National Oceanic and Atmospheric Administration**

Comment Number	Reported Comment	KPMG's Recommendation	NOAA Comments	KPMG Assessment of Current Status
		year and perform a periodic review of all assets entered into the property system during the fiscal year, to ensure propriety and accuracy.		
01-10	Accounting for Supplementary Stewardship Reporting Should be Strengthened	Initiate procedures to report performance outcomes and measures for Stewardship Investments.	Ongoing.	Ongoing (see comments in Exhibit A).

Key to Report References:

96-XX KPMG's Management Letter, issued in conjunction with NOAA's September 30, 1996 financial statements.
98-XX KPMG's Management Letter, issued in conjunction with NOAA's September 30, 1998 financial statements.
99-XX KPMG's Management Letter, issued in conjunction with NOAA's September 30, 1999 financial statements.
00-XX KPMG's Management Letter, issued in conjunction with NOAA's September 30, 2000 financial statements.
01-XX KPMG's Management Letter, issued in conjunction with NOAA's September 30, 2001 financial statements.

**Department of Commerce
FY 2002 Management Letter Comments for the
National Institute of Standards and Technology**

***Monitoring over the National Institute of Standards and Technology (NIST) Grant Files
Should be Improved***

During our test work over NIST grant disbursements, we noted that 2 out of 35 grant files, selected for test work, did not contain the required monitoring reports (SF-269s and SF-272s), which resulted in the grant recipient being noncompliant with the grant award conditions. We noted that the NIST grants' policy is to perform a "periodic" review during the fiscal year, in addition to an end-of-year review, to ensure that all grantee monitoring reports have been received.

Recommendation:

We recommend that the NIST Grants Officer:

1. Update the NIST grants manual to require review of the grant files and to follow up on missing documentation at June 30 and September 30, each year, to ensure that grantees comply with reporting requirements.

***Accounting for the National Telecommunications and Information Administration (NTIA)
Grant Accruals Should be Improved***

During our test work over grant accruals, we noted that the NTIA grants accrual, as of September 30, 2002, was recorded based on the FY 2001 calculation, rather than the FY 2002 calculation, resulting in a \$3 million understatement of the grant accrual.

Recommendation:

We recommend that NIST:

2. Follow existing review procedures to ensure that the proper grant accrual amount is recorded.

Accounting for Accounts Payable Should be Strengthened

During our test work over accounts payable, we noted that 1 out of 20 contracts, that we selected for review of contract retainage clauses, showed a holdback amount that was not accrued as of September 30, 2002, resulting in a \$33,890 understatement of accounts payable. We were told by NIST personnel that they do not record retainage amounts as liabilities. However, according to Statement of Federal Accounting Standards No. 1, *Accounting for Selected Assets and Liabilities*, liabilities should be recorded based on the cost of work completed, whether or not formal acceptance of the work has occurred.

**Department of Commerce
FY 2002 Management Letter Comments for the
National Institute of Standards and Technology, Continued**

Recommendation:

We recommend that NIST:

3. Perform a review of all contracts that contain contract retainage clauses quarterly, and implement a policy to record or adjust the liabilities for those amounts that have been held back.

Capturing Construction-Related Costs Should be Improved

During our test work over NIST's property, we noted that \$266,000 of costs allocated to cost center '0599' were not adequately supported as non-capitalizable real property. We determined that the allocation of costs is not consistent within NIST, resulting in costs being allocated to non-capitalized cost centers, without clear documentation supporting the cost allocation determination.

Recommendation:

We recommend that NIST:

4. Develop training to ensure consistency and clarity in documenting and allocating non-capitalized costs to cost centers for real property activity.

**Department of Commerce
Status of Prior Year Management Letter Comments
National Institute of Standards and Technology**

Comment Number	Reported Comment	KPMG's Recommendation	Department Comments	KPMG Assessment of Current Status
01-07	Documentation Related to Re-estimates of NIST's Environmental Liabilities Needs to be Improved	The data used to construct the environmental liability estimate be reviewed annually and the results of the review documented and retained by NIST.	Completed.	Completed.

Key to Report References:

01-XX KPMG's Management Letter, issued in conjunction with the Department's September 30, 2001 consolidated financial statements.

**Department of Commerce
FY 2002 Management Letter Comments for the
National Institute of Standards and Technology Servicing Other Bureaus using CAMS**

Accounting for Accounts Payable and Undelivered Orders Should be Improved

During our test work over accounts payable and undelivered orders, we noted:

- Five out of thirty-two accounts payable items tested, resulted in an overstatement of accruals in the amount of \$256,408. For certain accruals, bureau program managers record year-end accruals based on verbal confirmations with vendors. This resulted in variances between estimated accruals and actual invoices; and
- A significant number of unmatched transactions at the event level were in the undelivered orders and accounts payable subsidiary ledgers, which likely occurred during the conversion to CAMS. At the summary level, most of the undelivered orders and accounts payable “debit” balances were offset by “credit” balances. However, we identified a total of \$4.8 million in net debit balances to undelivered orders (in accounts labeled “Closing Project” and “O/SEC Default Account”) that are unmatched and need to be researched and corrected. We also noted one unmatched accounts payable balance, amounting to \$82,000.

Recommendations:

We recommend that:

1. NIST CAMS bureaus consider historical payment trends and estimates of work to be completed under contracts or agreements and consider reviewing subsequent disbursements, to better identify and estimate accruals; and
2. NIST Financial Services Group establish consistent transaction attributes to ensure the proper matching of undelivered orders and accounts payable with CAMS, at the transaction level, and research and resolve legacy system conversion transactions, to ensure that the undelivered orders and accounts payable balances are properly stated.

Security over Passwords for Federal Agencies’ Centralized Trial-Balance System (FACTS) II Submissions Should be Improved

During our test work over resource management, we noted one instance where individuals listed as the preparer and certifier on Form SF-133, *Report on Budget Execution and Budgetary Resources*, was not the individual who actually prepared and submitted the SF-133 to the Office of Management and Budget (OMB).

Recommendations:

We recommend that the NIST Deputy Chief Financial Officer:

3. Ensure that the NIST FSG does not share security passwords, among its employees; and

**Department of Commerce
FY 2002 Management Letter Comments for the
National Institute of Standards and Technology Servicing Other Bureaus using CAMS,
Continued**

4. Assign an individual within NIST to maintain and follow up on passwords obtained by the Department of Treasury, to assist with timely removal and addition of passwords for the NIST FSG.

Accounting for Internal Use Software Costs Should be Improved

During our test work over property for the Department Management Working Capital Fund, we noted that software development costs were not properly capitalized or posted to the correct property-related standard general ledger accounts, resulting in a net \$3.7 million understatement of the general property, plant, and equipment balance.

Recommendations:

We recommend that the NIST FSG:

5. Record or adjust, as appropriate, the internal use software, software in development, and accumulated amortization accounts, based on the “No. 10 Reports”; and
6. Establish and strengthen its internal controls and procedures to allow for proper and timely recognition of financial events related to internal use software, based on the data in the sub-ledger and the “No. 10 Reports.”

Department of Commerce
Status of Prior Year Management Letter Comments
National Institute of Standards and Technology Servicing Other Bureaus using CAMS

Comment Number	Reported Comment	KPMG's Recommendation	NIST (CAMS) Comments	KPMG Assessment of Current Status
01-06	Calculation of the Grant Accrual at Minority Business Development Agency (MBDA) Could be Improved	MBDA should consider when the last payments were made, and the expense period covered by the payment, when estimating accruals.	Completed.	Completed.
01-08	U.S. Department of Agriculture's National Finance Center (NFC) Report Should be Used to Calculate the Year-end Leave Accrual	ESA/BEA management use the information from the leave report to determine the amount to accrue for annual leave at the end of a fiscal year.	Completed.	Completed.

Key to Report References:

01-XX KPMG's Management Letter, issued in conjunction with the Department's September 30, 2001 consolidated financial statements.

**Department of Commerce
Status of Prior Year Management Letter Comments
Bureau of the Census**

Controls over Accounting for Reimbursable Agreement Authority Should be Strengthened

The Bureau of the Census (Census) provides goods and services to others through reimbursable agreements. Often, these agreements provide for Census to receive an advance that is subsequently adjusted as the goods or services are provided. During the FY 2002 audit, we found 3 out of a sample of 20 reimbursable agreements tested, where the advance amounts recorded in the accounting system, as of our July 31, 2002 test date, could not be supported by documentation maintained in Census' files, as follows:

	FY02 Agreement Authority per <u>Project File</u>	FY02 Agreement Authority per <u>System Report</u>	<u>Variance</u>
Project no. 7523000	\$10,700,000	\$17,057,194	\$(6,357,194)
Project no. 7800000	1,586,000	2,879,612	(1,293,612)
Project no. 7564000	242,000	246,201	(4,201)

Amounts shown for the first two projects were in the process of being adjusted by Census, following a detailed review of large reimbursable projects, and were subsequently adjusted in the September 30, 2002 system report. The variance shown for the third project resulted from a carryover of reimbursable agreement authority from FY 2001 to 2002 that was recorded in error. This resulted in an overstatement on the system report, and was corrected after our review date of July 31, 2002.

We also found one additional agreement with a negative "balance available for obligation" that resulted because the carryover form was not completed and sent to the Census Budget Division before the cut-off date of January 11, 2002.

GAO's *Standards for Internal Control in the Federal Government* require that, "All documentation and records should be properly managed and maintained." Regarding the carryover forms, the Census Comptroller issued guidance on December 20, 2001 stating, "All divisions sponsoring reimbursable work for fund codes 11 and 12 must begin preparing carryover requests for any remaining FY 2001 Agreement Authority amounts intended for use in FY 2002. Carryover requests are due in Budget Division no later than January 11, 2002."

**Department of Commerce
FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

Recommendations:

We recommend that Census:

1. Continue to take steps to ensure that reimbursable agreement authority recorded is properly supported and the appropriate documentation kept in each project folder; and
2. Enforce compliance with the internal guidance regarding carryover forms.

Advances for Reimbursable Agreements Should be Liquidated Timely

During the FY 2002 audit, we found that Census did not liquidate the “Advances from Others” account, for 9 projects out of a sample of 15 tested, in a timely manner.

For 8 out of the 9 exceptions, we determined that certain August 2002 costs were recorded in the Commerce Administrative Management System (CAMS) after the CMC 927 liquidation report was run and, as a result, did not get liquidated until September. Likewise, certain September 2002 costs were not liquidated until October 2002.

For the remaining exception, an adjustment for September 2002, was not recorded in the general ledger until October 2002, which was after the CMC 927 report was run, so it was not liquidated until October 2002.

Because liquidations for costs incurred in FY 2002 were not posted until October 2002, “Advances from Others,” “Unbilled Accounts Receivables,” and “Unfilled Customer Orders” were overstated at September 30, 2002.

GAO’s *Standards for Internal Control in the Federal Government* state, “Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records.”

Recommendation:

We recommend that Census:

3. Comply with its procedures regarding the monthly liquidation of “Advances from Others,” and ensure that any adjustments posted after the CMC 927 report is run, are reviewed to determine whether a liquidation entry is necessary.

**Department of Commerce
FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

Reimbursable Agreement Clearing Account Should not Contain Unsupportable Balances

During its reimbursable agreement clean-up process, Census adjusted the individual reimbursable project “Advance” and “Accounts Receivable” balances, based on the supporting documents in the file, with an offset to a balance sheet “Clearing Account.” This was done so that the overall general ledger trial balances at the fund code and fiscal year level remained unchanged, even though the individual reimbursable agreement trial balances have been corrected.

At September 30, 2002, the “Clearing Account” had a debit balance of \$7.2 million, representing \$3.9 million and \$3.3 million of corrections needed to “Accounts Receivable” and “Advances,” respectively. The “Clearing Account” balance is unsupported.

GAO’s *Standards for Internal Control in the Federal Government* states, “Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.”

Recommendation:

We recommend that the Census Finance Division:

4. Complete its clean-up effort, and write off any remaining balance in the “Clearing Account.”

Management of Census’ Working Capital Fund Needs Improvement

The purpose of the Census Working Capital Fund (WCF) is “for expenses and equipment necessary for the maintenance and operation of such services and projects as the Director of the Census Bureau determines may be performed more advantageously when centralized.” The fund operates without fiscal year limitations. During our analysis of the WCF, we noted an issue that requires management’s attention relating to maintaining a reasonable, but not excessive, equity reserve in that fund.

According to Census management, the WCF equity reserve should be about 5 percent of the fund’s total expenses. The balance at September 30, 2002 was \$29 million. However, we believe that the basis of the reserve should be reimbursable expenses only (i.e., excluding imputed costs and WCF expenses). At September 30, 2002, the WCF’s reimbursable expenses were \$321 million, 5 percent of which would equate to \$16 million. The difference of \$13 million represents a potential overstatement in the WCF’s

**Department of Commerce
FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

cumulative results of operations. Likewise, equity in the other Census funds are potentially understated.

The equity balances in the other Census funds are classified as either unexpended appropriations or cumulative results of operations. Reimbursable funds report only cumulative results of operations, and would not be affected by the potential overstatement in the WCF, described above. Therefore, an excessive or insufficient WCF equity reserve causes a misclassification of equity accounts for only the appropriated funds. We estimated that approximately 49% of the FY 2002 Census expenses were attributable to appropriated funds, based on the allocation of the FY 2002 WCF costs to other funds. Therefore, \$13,000,000 x 49% or \$6,370,000 of Census equity is misclassified.

In addition, we noted that the total WCF equity account balances have fluctuated significantly over the past three years, as follows:

September 30, 2000	\$20,097,000 Credit balance
September 30, 2001	\$85,439,000 Debit balance
September 30, 2002	\$65,303,000 Debit balance

Excessive and fluctuating equity balances in the WCF indicate that Census management is not analyzing the fund's operations frequently, to ensure that only a "reasonable reserve" is maintained, or to ensure that adjustments are made timely to the fund's reimbursement rates.

We believe that the WCF has an excess reserve as of September 30, 2002. The overall effect on Census' equity balance is an overstatement of cumulative results of operations and an understatement of unexpended appropriations of approximately \$6,370,000.

Recommendation:

We recommend that Census management:

5. Analyze the financial statements of the WCF and develop, document, and implement a process for analyzing the equity reserve balances on at least a quarterly basis. As a part of this process, Census management needs to reconsider whether a 5 percent reserve is necessary for this fund, and ensure that the reserve is maintained at a consistent level.

Fund Balance with Treasury Reconciling Items Should be Adjusted to the General Ledger in a Timely Manner

During our interim test work over Fund Balance with Treasury, we determined that some reconciling items remained unadjusted on Census' general ledger for several months.

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FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

The reconciliation for the month of May 2002 included \$115,644,549 of “adjusted reconciling items” that were not recorded in the general ledger as of May 31, 2002. This included \$40,116,296 in reconciling items related to NFC payroll disbursements. We also noted two other significant reconciling items that were related to NFC payroll disbursements in the amounts of \$40,998,209 and \$61,267,074 for the months of March and April 2002, respectively. Based on our review of subsequent Fund Balance with Treasury reconciliations for June and July 2002, the NFC payroll disbursements for March 2002 were still being reported as a reconciling item.

According to the *Treasury Financial Manual Supplement to Volume I TFM 2-5100*, “When any prior month difference is identified and substantiated, properly adjust the General Ledger or Statement of Transactions/Accountability to clear the difference.”

According to Census personnel, they consciously accepted these differences so they could adequately research them. These reconciling items were resolved by September 30, 2002. However, we concluded that Census research and resolution of these items should be timelier.

Recommendations:

We recommend that Census:

6. Take steps to ensure that reconciling adjustments are promptly recorded in the general ledger.

Supporting Documentation Should be Maintained for Internal Use Software

Our tests of Census’ internal use software, both completed and under development, indicated that these amounts are not always properly supported. Out of a sample of five internal use software projects valued at about \$17.1 million, we found four that did not have all the invoices or estimated accrual forms supporting the costs being reported to the Finance Division by the division chiefs. The costs associated with the four projects amounted to approximately \$9.1 million, or 53 percent of the sample dollar value. When we inquired about the missing supporting documentation, we were told that division chiefs do not always maintain that documentation. As a result, the amount capitalized by Census for internal use software may be misstated.

GAO’s *Standards for Internal Control in the Federal Government* states, “Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.”

**Department of Commerce
FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

Recommendation:

We recommend that:

7. The Census division chiefs, responsible for tracking internal use software expenses, ensure that supporting documentation is maintained, and that the Finance Division ensure that the costs being reported by the divisions are properly supported, prior to capitalizing those amounts in the property and equipment records.

Telecommunications Costs Should be Obligated Prior to Disbursement

Census does not obligate funds in advance for disbursements made to the U.S. General Services Administration for Information Technology Fund (ITF) services. During our final testwork over cash disbursements for the period July 1 through September 30, 2002, we found that the Census Finance Division did not obligate funds prior to payment for 2 cash disbursement items, out of a sample of 15.

OMB Circular No. A-11 (2002), Section 20.5, states, “When you place an order, sign a contract, award a grant, purchase a service, or take other actions that require the government to make payments to the public or from one government account to another, you incur an obligation.”

We were told that obligations are not recorded for telecommunications services, because Census management believes that it is difficult to estimate the actual amounts for these services, in advance. However, because there is no obligation, Census runs the risk of violating the *Anti-Deficiency Act*, by spending funds that may no longer be available.

Recommendation:

We recommend that Census:

8. Review historical data related to payments for telecommunications services, to develop an estimate that can be used to establish obligations for these costs.

Management Review is Needed to Prevent Budgetary Adjustments

During FY 2002, Census made several large budgetary adjustments, described in more detail, below.

- At the end of FY 2001, the Census Decennial fund’s budgetary disbursements account reflected more disbursements than Treasury’s records. This out-of-balance condition did not pass the FACTS II edit checks. To allow FACTS II submission, Census reduced its budgetary disbursements account and increased the amount reported as

**Department of Commerce
FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

still payable. This had no overall effect on the September 30, 2001 SF-133, *Report on Budget Execution*.

This entry was to have been reversed during FY 2001, but was not reversed until FY 2002. Therefore, an incorrect amount was reflected in the "Brought Forward October 1" line on the FY 2002 SF-133, resulting in an overstatement of approximately \$19 million. Census has corrected this matter in its budgetary accounts as of September 30, 2002, and it appears on the September 2002 financial statements as a beginning balance adjustment.

- A \$68 million adjustment occurred because of a change in accounting procedure for the Census Working Capital Fund, that was not reflected in the budgetary accounts, related to intra-bureau transactions. Subsequently, Census has revised its transaction codes so that this condition will not occur in the future, and an adjustment was made to the FY 2002 consolidated financial statements for the Department.
- Census misclassified \$533 million of obligations incurred as "direct," rather than "reimbursable," in its financial submission to the Department, which caused a late adjustment to be required to the Department's Statement of Budgetary Resources.

Recommendation:

We recommend that Census management:

9. Provide additional oversight in the area of budgetary accounting, to prevent adjustments of this magnitude in the future. Census' fiscal year 2002 corrective actions for the adjustments, described above, are appropriate.

Automated Controls over Reimbursable Agreements Should be Strengthened

Reimbursable projects are individually tracked within Census' automated system. Each has individual accounting records and levels of authorized funding. To ensure that the authorized funding is not exceeded, Census performs manual checks for available funds at the project level. If funds are determined to be available, obligations can be made against those funds.

During our review of authorized funding for reimbursable agreements we found 4 projects out of a sample of 35 where the authorized funding, at the project level, had been exceeded.

Census' standard procedures state, "The Available Order amount should always exceed the unbilled costs. If a situation occurs where this is not the case, one or more of the following may be true:

- Work may have been performed that exceeded the authorized funding. In this case, the Sponsoring Division should be notified immediately.

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FY 2002 Management Letter Comments for the
Bureau of the Census, Continued**

- The system may not fully reflect the authorized funding because: 1) Finance overlooked recording an incremental customer order amount at the start of a new period (e.g., quarter), 2) the sponsoring division and/or the customer did not forward a modification to the BC-505A to Finance indicating an increase in authorized funding, and 3) a balance remaining at the end of the year may not have been carried forward, etc.”

For three of the four projects listed above, Census overspent its estimate of costs related to these projects. The other project was charged expenses in error, causing the authorized funding to be exceeded. In each case, Census was not in compliance with its standard procedures cited above.

Recommendation:

We recommend that Census:

10. Implement a system control edit check to verify whether a project has authorized funding for a specific project and reject the transaction if no funding is authorized.

**Department of Commerce
Status of Prior Year Management Letter Comments
Bureau of the Census**

Comment Number	Reported Comment	IPA's Recommendation	Census' Comments	KPMG Assessment of Current Status
01-1	The Periodic Censuses and Programs appropriation and the Working Capital Fund had debit balances in accounts with normal credit balances and vice versa in prior year fund codes.	Census should review prior year fund code amounts for abnormal balances during the monthly reconciliation process.	Completed.	Completed.
01-2	Census did not formally review budgetary accounts for accuracy. Census could not reconcile the balances brought forward to the prior year's post closing general ledger.	Census should develop policies and procedures for monthly reconciliation of budgetary transactions to the general ledger.	Completed.	Completed.
01-3	Payroll forms were not properly approved or completed.	The Human Resources Division should ensure the appropriate officials properly approve all payroll-related forms.	Completed.	Completed.

Key to Report References:

Comment Nos. 01-1 through 01-3 are presented in the Management Letter to Census, dated January 11, 2002, by Urbach, Kahn and Werlin.

**Department of Commerce
FY 2002 Management Letter Comments for the
Economic Development Administration**

Accounting for Grant Advances and Documentation over the Economic Development Administration (EDA) Grant Files Should be Improved

EDA grant activities are conducted at regional offices in addition to the Washington, DC location. The Grants Officers are designated as the custodian of the official award file. However, the EDA Accounting Division is responsible for the financial and accounting duties related to the grants.

During our test work over grant advances and grant payables, we noted the following:

- Sixteen out of eighty-one instances (from our disbursement controls and undelivered orders test work) where the EDA Accounting Division did not receive Form CD-451, *Amendment to Financial Assistance Award*, from the Regional Offices prior to the expiration of each funding period. Of these 16, 12 had extension approvals documented via a Form ED-506, *Correspondence Brief Memorandum* or other correspondence that was maintained at the regional office level. However, we were not provided documentation to support the extension on the remaining 4 grants.
- For the 12 grants where extensions were documented via a Form ED-506, the approval date was subsequent to the expiration date, and grant payments were made between the original expiration date and the extension approval documentation.
- Eleven out of thirty instances (from expired grant files test work), the EDA Accounting Division did not maintain an authorized close-out memorandum.
- Twenty out of thirty instances (from expired grant files test work) were not closed timely (that is, the de-obligation was not entered in the accounting system within 120 days after the grant expiration date). We were told that the EDA Accounting Division does not always receive the close-out memorandums from Grant Officers, timely. Grant closing delays ranged from 4 days to 3 years.
- Three advance payments totaling \$104,000, were made to grantees over one year ago and remain recorded as an "Advance to Others." EDA was aware of these cases and has been working with system personnel to write off these advances.
- The amount recorded as a grant accrual in CAMS disagreed with the grant accrual spreadsheet, resulting in a \$1.5 million understatement of grant accruals. This difference occurred because of an error in the spreadsheet formula.

Recommendations:

We recommend that the EDA:

1. Review its grants manual, in conjunction with the OMB Circulars, the Department's guidance, and other Department bureaus' grants manual to develop clearer grant documentation requirements, including defining specifically what documentation is to be maintained at the regional office level, versus at the Accounting Division. If extension dates

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are not entered into the grant subsidiary system, we believe consideration should be given to including such dates in the system, to more easily monitor the grant expiration dates.

2. The Accounting Division should ensure that it maintains the close-out memorandums for all grants that are requested by the regional offices to close.
3. Set specific time periods for periodic reviews of grant expiration dates to ensure that the Grant Officers are following up with the grantees, and either notifying the EDA Accounting Division to de-obligate grants in a timely manner, or preparing documentation of grant extensions;
4. Perform a detailed review of the grant accrual spreadsheet for accuracy, including verification of data input and agreement to the subsidiary ledger; and
5. Research all grant advances that are outstanding for more than one year, and expense those where the amounts have likely been spent by the grantee.

Reconciliation of Fund Balance with Treasury Should be Conducted in a Timely Manner

EDA's Fund Balance with Treasury was not reconciled at fiscal year end, timely. The September 2002 *Statement of Differences for Disbursements* was not reconciled for agency location code number 13200001, until December 9, 2002.

Recommendation:

We recommend that the EDA:

6. Reconcile all of its Fund Balance with Treasury accounts, monthly, as required in the Treasury Financial Manual, Supplement to Volume I, Section V, Subsection A, *Periodic Review and Evaluation*.

**Department of Commerce
Status of Prior Year Management Letter Comments
Economic Development Administration**

Comment Number	Reported Comment	KPMG's Recommendation	EDA Comments	KPMG Assessment of Current Status
01-01	Advances to Others Accounting Could be Improved	EDA should note the amount listed on the first line of the request, "Total Program Outlays to date" when requests for disbursement are submitted by grantees.	Completed.	Completed.

Key to Report References:

01-XX KPMG's Management Letter, issued in conjunction with the Department's September 30, 2001 consolidated financial statements.

**Department of Commerce
FY 2002 Management Letter Comments for the
International Trade Administration**

Foreign Service Nationals (FSN) Accrued Severance Liability Accounting Should be Improved

During our test work over the International Trade Administration (ITA) voluntary separation pay liability, we noted that the Department of Interior's National Business Center (NBC) did not follow the voluntary separation plan provided by the respective country to calculate the liability. Specifically, we interpreted the voluntary separation pay plan for Ecuador in a different manner than NBC. NBC's calculation is a less conservative method, resulting in an understatement of the liability in the amount of \$48,000.

Recommendation:

We recommend that NBC:

1. Calculate the voluntary separation pay liability for Ecuador based on the more conservative interpretation of the plan.

Accounting for Prepaid Leases Should be Improved

During our test work over ITA's prepaid leases, we noted one (the South African, Capetown lease) out of six leases, which had a service period of March 1, 2002 through February 28, 2003, that was recorded as a prepayment as of September 30, 2002. The prepaid balance per ITA's records was \$83,827, whereas we calculated the prepaid balance to be \$58,663, based on the lease agreement service period. Therefore, the prepaid balance is overstated by \$25,163, calculated based on the average exchange rate for March 2002.

Recommendation:

We recommend that ITA:

2. Verify exchange rate information, and thoroughly review the lease agreements to ensure prepaid lease amounts are properly recorded.

Segregation of Duties for Collections at ITA's Foreign Commercial Service (FCS) in Mexico City, Mexico Should be Improved

During our trade events test work, we noted two instances where proper segregation of duties did not exist.

- The Collection Clerk and the Commercial Specialist have the ability to change participation agreement fees.

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FY 2002 Management Letter Comments for the
International Trade Administration, Continued**

- The Collection Clerk serves as the back-up for the sub-cashier. Therefore, the Collection Clerk could record a collection on e-menu and make the cash deposit, which are incompatible duties.

Recommendations:

We recommend that the FCS Mexico City:

3. Evaluate its operations to consider giving only one person, either the Commercial Specialist or the Collection Clerk, the ability to change participation agreement fees. The person with this function should be the one least likely to receive cash or check payments; and
4. Assign the sub-cashier back-up function to an employee other than the Collection Clerk.

**Department of Commerce
Status of Prior Year Management Letter Comments
International Trade Administration**

Comment Number	Reported Comment	KPMG's Recommendation	ITA Comments	KPMG Assessment of Current Status
01-02	Accounting for Prepaid Leases Could be Improved	ITA should request copies of payment receipts/invoices for all lease payments.	Ongoing.	Ongoing (see comments in Exhibit G).
01-03	Foreign Service Nationals (FSN) Accrued Severance Liability Accounting Could be Improved	An individual not involved with the FSN calculation (an ITA staff member or National Business Center staff member not involved in the calculation) should review the spreadsheet used to identify any errors in formulas, and agree the methodology used to create the formulas to the original agreements.	Ongoing.	Ongoing (see comments in Exhibit G).
01-04	Payroll Controls Could be Improved at ITA's Brasilia Office	Supervisors and employees complete the required form Authorization for Irregular or Occasional Overtime.	Completed.	Completed.

Key to Report References:

01-XX KPMG's Management Letter, issued in conjunction with the Department's September 30, 2001 consolidated financial statements.